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Do You Psyche Yourself Out as an Investor?

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One of the most fundamental pieces of investment advice is "buy low and sell high" – a concept that is very easy to understand and agree with, but often much harder to live by. Especially in uncertain market environments like we have seen recently, the rational implementation of this strategy goes against every instinct and emotion a normal person has. Our Wealth Management Insights brief for June is designed to help you understand what motivates poor investment decisions so you can avoid them when working with your Financial Advisor.

The natural attraction one feels toward a high-performing investment can make it very easy to "buy high".

What You Should Know:

1. Fear is a powerful motivator.

There have been many unknowns weighing on investors' minds in recent years, including the sustainability of the U.S. economic recovery, how the European debt crisis may impact global markets and what the outcome of this year's presidential election might mean for U.S. monetary and fiscal policies. These lingering uncertainties drove persistent, wild market volatility in 2011 and remain concerns for investors today.

- The natural impulse when a stock goes down is to sell, as many did in August of 2011 when the Dow dropped by hundreds of points on several different days.
- Those who reallocated their portfolios away from equities or exited the market entirely missed out on the bull run that brought the Dow back above 13,000 by March.
- Absent fundamental shifts in the investment environment, fluctuations could be viewed as tactical opportunities for investors with a nimble strategy and flexibility in a portion of their asset allocation.

2. Doing nothing is not an option.

Fear of the unknown doesn't just drive poor sell decisions or overly defensive reallocations. In some cases, it can completely paralyze an investor.

- In markets that are moving frequently or rapidly, inaction can be more dangerous than making a bad short-term call.
- Many modern portfolios are constructed with a certain amount of flexibility, so that a portion of the assets can be reallocated tactically to hedge against headwinds or capitalize on upswings.
- Be careful not to become overly aggressive when trying to make up for market losses or pursuing perceived opportunities.

3. Overconfidence can be dangerous.

Certainly investor confidence as measured by most economists can give an indication of near-term market performance. But there is the danger of an individual investor being overconfident based on an incomplete analysis of an investment opportunity.

- The natural attraction one feels toward a high-performing investment or asset class can make it very easy to "buy high", as many home owners did before the housing bubble burst in 2007.
- Past performance – especially the relatively recent past – should not be the only criterion one uses to evaluate any investment.
- The current price of an investment should be evaluated in terms of its historical mean and potential value using multiple benchmarks and reference points.

4. Perspective can help you overcome your emotions.

Keeping your long-term goals and the bigger picture in perspective can be difficult, but it is the best way to prevent the buy or sell impulses associated with daily volatility from leading you down the wrong path. Following are some important tips to keep in mind:

- Financial headlines in our 24/7 news cycle are designed to grab your attention. Before you act on the news, consider that by the time you hear them the market has almost always priced it in already.
- Don't let abnormal, one-off events or wishful thinking dictate your investment strategy.
- Keep accurate records of why you make specific investment decisions and revisit these reasons before reversing those decisions or dramatically altering your course.

What you should do now:

Taking the time to think about a decision can be the hardest part of rational investing, but it is also the most crucial. While timing is obviously important, the success of a long-term financial plan is almost never made or broken in a single trading day. If an investment is worth considering, it is worth taking the time to discuss and evaluate with your trusted Financial Advisor.